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SARA L. KISTLER

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEVADA

In re:

THE RHODES COMPANIES,
aka "Rhodes Homes, et al.,"¹

Debtor(s).

CASE NOS: BK-S-09-14814-LBR
(Jointly Administered)

Chapter 11

Date: May 15, 2009

Time: 10:00 a.m.

Location: Foley Courtroom 1

THE ACTING UNITED STATES TRUSTEE'S OPPOSITION TO DEBTORS'
MOTION TO PAY SALARY TO JAMES M. RHODES

The Acting United States Trustee opposes the debtors' motion to pay a salary to James

¹ The Debtors in these cases, along with their case numbers are: Heritage Land Company, LLC (Case No. 09-14778); The Rhodes Companies, LLC (Case No. 09-14814); Tribes Holdings, LLC (Case No. 09-14817); Apache Framing, LLC (Case No. 09-14818); Geronimo Plumbing, LLC (Case No. 09-14820); Gung-ho Concrete, LLC (Case No. 09-14822); Bravo, Inc. (Case No. 09-14825); Elkhorn Partners (Case No. 09-14828); Six Feathers Holdings, LLC (Case No. 09-14833); Elkhorn Investments, Inc. (Case No. 09-14837); Jarupa, LLC (Case No. 09-14839); Rhodes Realty, Inc. (Case No. 09-14841); C & J Holdings, Inc., (Case No. 09-14843); Rhodes Ranch GP (Case No. 09-14844); Rhodes Design & Dev. (Case No. 09-14846); Parcel 20, LLC (Case No. 09-14848); Tuscany Acquisitions, IV, LLC (Case No. 09-14849); Tuscany Acquisitions III, LLC (Case No. 09-14850); Tuscany Acquisitions II LLC (Case No. 09-14852); Tuscany Acquisitions, LLC (Case No. 09-14853); Rhodes Ranch Golf (Case No. 09-14854); Overflow, LP (Case No. 09-14856); Wallboard, LP (Case No. 09-14858); Jackknife, LP (Case No. 09-14860); Batcave, LP (Case No. 09-14861); Chalkline, LP (Case No. 09-14862); Glynda, LP (Case No. 09-14865); Tick, LP (Case No. 09-14866); Rhodes Arizona Properties, LLC (Case No. 09-14868); Rhodes Homes Arizona, LLC (Case No. 09-14882); Tuscany Golf Country Club, LLC (Case No. 09-14884); and, Pinnacle Grading, LLC (Case No. 09-14887).

1 M. Rhodes (“Motion”). The Motion seeks authorization to pay James M. Rhodes, the Debtors’
 2 president and an insider, his annual prepetition salary of \$400,000. Because Mr. Rhodes is an
 3 insider, 11 U.S.C. § 503(c) is implicated. The Acting United States Trustee requests that the
 4 Court deny the relief requested in the Motion, limiting any post-petition salary for Mr. Rhodes to
 5 an amount that is actually and reasonably necessary to preserve the Debtors’ estates. This
 6 opposition is supported by the following Memorandum of Points and Authorities, the file and
 7 pleadings in this case.

8 MEMORANDUM OF POINTS AND AUTHORITIES

9 1. Pursuant to 28 U.S.C. § 586(a)(3), the Acting United States Trustee is charged with
 10 responsibility for supervising the administration of cases under Chapters 7, 11, 12 and 13 of the
 11 Code. The Acting United States Trustee has standing to raise and to “appear and be heard on
 12 any issue in any case or proceeding” brought under the United States Bankruptcy Code
 13 (“Code”).² 11 U.S.C. § 307.

14 2. All debtors commenced their individual cases by filing voluntary petitions under the
 15 Code on March 31, 2009, with the exception of Rhodes Homes Arizona, LLC, Tuscany Golf
 16 Country Club, LLC and Pinnacle Grading, LLC, which filed voluntary petitions under the Code
 17 on April 1, 2009.

18 3. No Chapter 11 trustee has been appointed in these cases and the debtors operate as
 19 debtors-in-possession.

20 4. These cases are jointly administered under the lead case styled, In re The Rhodes
 21 Companies, Case No. 09-14814-LBR. [Docket Entry # 18]

22 5. On April 1, 2009, Debtors filed a Motion for Order Under 11 U.S.C. §§ 105, 363,
 23 503(b), 1107 and 1108 Authorizing (I) Maintenance of Certain Existing Bank Accounts, (II)
 24 Continued Use of Business Forms, (III) Continued Use of Existing Cash Management System,
 25 (IV) Providing Administrative Priority Status to Postpetition Intercompany Claims, and (V)
 26 Waiver of Section 345(b) Deposit and Investment Requirements [Docket Entry # 10].

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 28 ² 11 U.S.C. § 101 *et seq.*

1 6. Pursuant to an agreement between the Acting United States Trustee and the Debtors,
 2 the order approving post-petition payment of the employees of the Debtors provided that any
 3 “compensation for post-petition Wages for James M. Rhodes or any of his relatives shall be
 4 made by separate application of the Debtors by way of motion for insider compensation.”
 5 [Docket # 19, p. 4 of 5]

6 7. In 2005, long after the 1990 case cited by the Motion, the Code was amended through
 7 the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”).
 8 One of the changes made was the addition of Section 503 (c) to the Code, which was enacted
 9 “to limit a debtor’s ability to favor powerful insiders economically and at estate expense during a
 10 chapter 11 case.” In re Pilgrim’s Pride Corp., 401 B.R. 229, 234 (Bankr. N.D. Tex. 2009), *citing*
 11 In re Airway Industries, Inc., 354 B.R. 82, 87 n. 12 (Bankr. W.D. Pa. 2006).

12 8. Section 503 (c) addresses several types of insider compensation which is not
 13 permitted absent certain court findings. *See* 11 U.S.C. § 503 (c)(1) and (2). Section 503(c)(3)
 14 is a general provision that prohibits “other transfers and obligations that are outside the ordinary
 15 course of business and are not justified by the facts and circumstances of the case, including
 16 transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants
 17 hired after the date of the foiling of the petition.” 11 U.S.C. § 503(c)(3). Recent court decisions
 18 have held that a standard higher than the simple business judgement test applies when analyzing
 19 transfers implicated by Section 503 (c)(3). *See, e.g., In re Pilgrim’s Pride Corp.*, 401 B.R. 229,
 20 236-37 (Bankr. N.D. Tex. 2009) (citations omitted); *but see, e.g., In re Dana Corp.*, 358 B.R.
 21 567, 576 (Bankr. S.D.N.Y. 2006).

22 9. Because the Code does not provide guidance as to what constitutes the “ordinary
 23 course of business,” courts use a horizontal and vertical test to make that determination:

24 The inquiry deemed horizontal is whether, from an industry-wide perspective, the
 25 transaction is of the sort commonly undertaken by companies in that industry. The
 26 inquiry deemed vertical analyzes the transactions ‘from the vantage point of a
 27 hypothetical creditor and [the inquiry is] whether the transaction subjects a
 28 creditor to economic risk of a nature different from those he accepted when he
 decided to extend credit.

In re Dana Corp., 358 B.R. 567, 580 (Bankr. S.D.N.Y. 2006)(citations omitted).

1 10. Debtors seek the Court's approval to pay their president, James M. Rhodes, the same
2 exact salary he was paid before the commencement of these bankruptcies when the Debtors'
3 business operations were of a much greater magnitude than they are presently.

4 11. At the meeting of creditors, the Debtors' consultant and former chief financial officer
5 Paul Huygens testified that the Debtors have been doing extensive cost cutting for the last two
6 years, making reference to 11 of the 32 jointly administered debtors that are either not operating
7 or in wind-down mode. Based on Mr. Huygens' testimony at the 341 meeting of creditors, the
8 Debtors had approximately 1500 employees at the peak of the real estate development market
9 and "by way of comparison it's less than a hundred now." Mr. Huygens also acknowledged that
10 the Debtors have "cut and cut and cut and cut and cut," by shutting down offices in Las Vegas
11 and Arizona, shutting down model complexes, laying off employees, selling equipment and
12 noting "it's screeching to a halt as quickly as it can possibly be done." [Testimony of Paul D.
13 Huygens, 341 meeting of creditors, May 7, 2009, at 1:09:04 through 1:09:50; see also Docket #
14 64 at p. 5 of 44]

15 12. Paying Mr. Rhodes the same amount of compensation he received pre-petition in
16 light of the extensive cost cutting measures testified to by Mr. Huygens at the 341 meeting of
17 creditors appears to be outside the ordinary course of the Debtor's business, in view of the
18 decline in the Las Vegas real estate market. A hypothetical investor could also be reasonably
19 expected to view as extraordinary the Debtors paying the same wage to Mr. Rhodes while
20 making drastic cuts everywhere else in the run up to bankruptcy and considering the present state
21 of the Debtor entities. The Debtors have not provided evidence that Mr. Rhodes had reduced his
22 salary as part of the Debtors' extensive cost cutting measures in the period before they filed
23 bankruptcy. It would be reasonable for a hypothetical investor to expect such measures to be a
24 part of the cost cutting measures in order to avoid draining the Debtors of assets through
25 administrative fees post-petition. Therefore, it appears that the proposed payment at pre-petition
26 levels may be outside the ordinary course of business and therefore subject to scrutiny under
27
28

1 Section 503(c)(3).³

2 13. Under section 503(c)(3) the payment of a salary to Mr. Rhodes at the pre-petition
3 level does not appear to be appropriate. Eleven of the debtors are non-operating wind-down
4 companies, and an additional eight companies are simply holding companies. In addition, based
5 a review of the summary of schedules filed in the 32 individual bankruptcy cases, the Debtor
6 entities have assets that appear to be comprised of approximately \$120 million in real estate and
7 \$300 million in inter-Debtor receivables, while facing liabilities that appear to exceed \$500
8 million. Paying the Debtors' insider at his prepetition salary level does not appear to be in line
9 with the Debtors' extensive cost cutting measures, and will drain additional assets from the
10 Debtors' already strapped estates in the form of significant administrative expenses.

11 **WHEREFORE**, the Acting United States Trustee requests that the Motion be denied to
12 the extent that the amount of compensation requested is not actually and reasonably necessary to
13 preserve the Debtors' estates or to the extent that Debtors do not show that the pre-petition salary
14 the Debtors seek to pay Mr. Rhodes is commensurate with the extensive cost cutting measures
15 that the Debtors have undertaken in the two years before filing these Chapter 11 cases.

16 Dated: May 8, 2009

17 Respectfully submitted,

18 **THE UNITED STATES TRUSTEE**

19 By: /s/ Edward M. McDonald Jr.
20 Edward M. McDonald Jr., Esq.
21 Attorney for the United States Trustee
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26 ³ It is also important to note that both the Motion and supporting Declaration of
27 Paul David Huygens assert that loss of Mr. Rhodes' services would hurt the
28 Debtors' operations, which could be read as implicating coverage of 11 U.S.C. § 503
(c)(1) and its requirements. [See Docket # 94, p. 9 of 9; Docket # 96, p. 4 of 4, para. 16].

CERTIFICATE OF MAILING

I, the undersigned, hereby certify and declare that I deposited a true and correct copy of this opposition in first class United States mail, postage fully prepaid, and, if a facsimile number is listed, by facsimile, on this date to each of the parties listed below:

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Dated: May 8, 2009

OFFICE OF THE UNITED STATES TRUSTEE

By: /s/ Edward M. McDonald Jr.
An Authorized Employee of the United States Trustee